Office of Chief Counsel
Internal Revenue Service

memorandum

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RTBennett

date: AUG 0 2 2002

to: [redacted], Team Coordinator

from: Area Counsel
(Heavy Manufacturing and Transportation: Edison)

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subject: **Dual Consolidated Losses**
Taxpayer: [redacted]
EIN: [redacted]
UIL: 1503.04-00

This memorandum responds to your request for assistance dated June 28, 2002. This memorandum should not be cited as precedent.

I. Introduction.

Please accept this advisory memorandum as a response to the taxpayer [redacted] ("taxpayer") [redacted] memorandum ("Taxpayer memo") on the issue of dual consolidated losses of the dual resident corporation [redacted] for tax years ending September 30, [redacted], September 30, [redacted] and September 30, [redacted].

II. Issue.

Whether the taxpayer has met its burden of proving that the losses of the dual resident corporation [redacted] meet the exception to the definition of a dual consolidated loss under Treas. Reg. §1.1503-2(c)(5)(ii)(A)?

III. Conclusion.

The taxpayer has not met its burden of proving that the losses of the dual resident corporation [redacted] meet the exception to the definition of a dual consolidated loss under Treas. Reg. §1.1503-2(c)(5)(ii)(A).

IV. Facts.

The relevant facts of this case stated in our prior advisory memorandum dated December 21, 2001 are repeated here for

convenience. The facts are supplemented where appropriate.

The taxpayer is a domestic corporation that was incorporated in the United States in [redacted]. [redacted] was created to facilitate a demerger of the United Kingdom corporation [redacted] PLC ("[redacted]"). [redacted] is a holding company which wholly owns [redacted] Inc. another domestic holding company. [redacted] in turn owns numerous corporations operating in the United States which were previously indirectly owned by [redacted]. [redacted] also wholly owns [redacted], a U.K. holding company.

[redacted].

[redacted] is a dual resident corporation for purposes of the dual consolidated loss rules. Treas. Reg. 1.1503-2(c)(2).

In tax years ending [redacted], [redacted] and [redacted], [redacted]. It is believed that [redacted] was not part of any group for group relief purposes in the U.K. at any time during the tax years ending [redacted], [redacted] and [redacted].

The taxpayer filed consolidated returns in the U.S. for the tax years ending [redacted], [redacted] and [redacted]. On its returns, [redacted] reported that [redacted] itself earned either extremely little profit or loss. [redacted] reported that it received a management fee from [redacted]. The management fee income essentially offset its expenses. Currently, the examination team is analyzing whether [redacted], and not [redacted], was actually performing the management services. If this is the case, the examination team is considering making adjustments which would result in (1) a management fee being paid by [redacted] to [redacted] and/ or (2) allocating expenses reported by [redacted], but determined to be attributable to [redacted], to [redacted].

Either of these adjustments would create a loss in each of the three years for [redacted]. The examination team would propose that [redacted] is a "dual resident corporation" under section 1503 and its losses, as "dual consolidated losses," could not be used to offset the income of any of its U.S. affiliates.

The taxpayer states that [redacted] compensates its non-executive board members but not its executive board members. The taxpayer

further states that it charged "[redacted]." Taxpayer memo, p. [redacted]. The taxpayer lists [redacted] activities undertaken by the [redacted] board of directors at its meetings. These activities include: [redacted]. The taxpayer also notes that [redacted] provided its subsidiaries with [redacted]. Taxpayer memo, p. [redacted].

V. Dual resident corporations and dual consolidated losses.

A "*dual resident corporation*" *is a domestic corporation* that is subject to the income tax of a foreign country on its worldwide income or on a residence basis. Treas. Reg. §1.1503-2(c)(2). If a dual resident corporation is a resident of a foreign country in which the law permits the losses of such corporation to be used to offset the income of other commonly controlled resident corporations then the dual resident corporation may be able to use a single economic loss to offset two separate items of income, i.e. separately offset the income of its affiliates which are residents in the United States and again offset the income of its affiliates which are residents *only in the foreign country. This practice is referred to as* "double dipping." British Car Auctions, Inc. v. United States, 35 Fed Cl. 123, 125 (1996), aff'd per curiam, 116 F.3d 1497 (Fed Cir. 1997).

The United States Congress addressed the practice of double dipping in the Tax Reform Act of 1986 with the enactment of section 1503(d).[1] Section 1503(d)(1) states:

> "The dual consolidated loss for any taxable year of any corporation shall not be allowed to reduce the *taxable income of any other member of the affiliated* group for the taxable year or any other taxable year."

A dual consolidated loss is "any net operating loss of a domestic corporation which is subject to an income tax of a foreign country on its income without regard to whether such income is from sources in or outside of such foreign country, or is subject to such a tax on a residence basis." Section 1503(d)(2)(A).

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[1]Unless otherwise indicated, all section references denote the Internal Revenue Service of 1986 as in effect for the years in issue.

A dual consolidated loss does not include a net operating loss incurred by a dual resident corporation in a foreign country whose income tax laws (1) do not permit the dual resident corporation to use its losses, expenses or deductions to offset the income of any other person that is recognized in the same taxable year in which the losses, expenses or deductions are incurred ("stand alone" test) and (2) do not permit the losses, expenses or deductions of the dual resident corporation to be carried over or back to be used by any means, to offset the income of any other person in other taxable years ("carry over" test). Treas. Reg. §1.1503-2(c)(5)(ii)(A)(1) and (2). Under the carry over test, the taxpayer bears the burden of proving that no other person could possibly use the losses to offset income at any other time. The exception rarely applies. T.D. 8434, 1992-2 C.B. 240, 241.

The regulations contain an anti-"mirror legislation" provision. Treas. Reg. §1.1503-2(c)(15)(iv). This generally provides that where the income tax laws of a foreign country deny the use of losses, expenses, or deductions of a dual resident corporation to offset the income of another person because the dual resident corporation is also subject to income taxation by another country on its worldwide or residence basis, the dual resident corporation shall be treated as if it actually had offset its dual consolidated loss against the income of another person in such foreign country. Id.. The validity of the anti-mirror legislation was confirmed in British Car, 35 Fed. Cl. at 133.

Shortly after the enactment of section 1503(d) in 1986, the United Kingdom enacted it own dual consolidated loss rules. These rules are contained within the U.K. Income and Corporation Tax Act ("ICTA") at section 404. Effective for the 1987 tax year, under United Kingdom law,

> Notwithstanding any other provision of this Chapter, no loss or other amount shall be available for set off by way of group relief in accordance with section 403 if, in the material accounting period of the company which would otherwise be the surrendering company, that company is for purposes of this section a dual resident investing company. ICTA §404.[2]

This may have the effect of the loss being disallowed in both

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[2]Unless otherwise indicated, all references to the "ICTA" denote the Income and Corporation Tax Act of 1988 as in effect for the years in issue.

countries. British Car, 35 Fed. Cl. at 130. A taxpayer may not rely solely on a foreign country's mirror legislation to prove that its losses are not dual consolidated losses. Id..

The regulations under section 1503 provide two means by which the taxpayer can utilize a dual consolidated loss. First, a taxpayer may use a dual consolidate loss to offset the income of affiliated domestic corporations if it files an agreement with its tax return stating that it will not use the dual consolidated loss to offset the income of another person under foreign law. Treas. Reg. §1.1503-2(g)(2). However, a taxpayer can not utilize this exception if the foreign country at issue has enacted its own mirror legislation. British Car, 135 Fed. Cl. at 126, n.1; Treas. Reg. §1.1503-2(c)(16), ex. 5. Second, a taxpayer may avoid the dual consolidated loss rules if the United States and the foreign country have entered into a bilateral agreement permitting it. Treas. Reg. §1.1503-2(g)(1). The United States has not entered into any such agreement with any country to date.

VI. Synopsis of taxpayer's [redacted] memorandum.

In its [redacted] memorandum the taxpayer attempts to meet its burden of proving that [redacted]'s losses for the tax years [redacted], [redacted] and [redacted] are not dual consolidated losses. The taxpayer argues that [redacted]'s losses are not dual consolidated losses because the losses meet the requirements under Treas. Reg. §1.1502-2(c)(5)(ii)(A) to be excepted from the definition of a dual consolidated loss. As noted above the exception has two tests, the "stand alone" test and the "carry over" test.

Since it appears that the taxpayer has met the stand alone test, the issue turns on the carry over test. The taxpayer argues that the only way under U.K. law by which another party could use any of the losses in other taxable years is under the restructuring provision ICTA §343.[3] According to the taxpayer, under ICTA §343 only trading losses sustained by a party carrying on a trade may be carried forward and used by another party under ICTA §393 which begins to carry on that trade. The taxpayer argues that therefore if [redacted] was not carrying on a trade then it could not have had trading losses to be carried forward under ICTA §393. Hence, ICTA §343 would not apply.

In its discussion of the "Status of [redacted]" the taxpayer initially implies that [redacted] is both an investing company and an investment company but states that it will not specifically flesh out these implications. ("Whilst the status of [redacted] as either a

[3]Relevant U.K. law is set forth under section VII below.

Dual Resident Investment Company and/or an Investment Company may therefore provide a strong indication that the company is **not** carrying on a trade, on the basis that this is not 100% conclusive, this point will not be examined further." (emphasis included) Taxpayer memo, p.[redacted]). Rather, the taxpayer delves into a factual analysis of whether [redacted] was carrying on a trade.

The taxpayer readily acknowledges that U.K. statutory authority is not helpful in determining whether a company is carrying on a trade. The taxpayer resorts to case law. The taxpayer provides several quotations from U.K. case law all of which make it clear that a determination of whether a company is carrying on a trade is based purely on the facts and circumstances of the particular case. The taxpayer cites Lord Wilberforce in the Livingston case as follows: "'Trade' can not be precisely defined, but certain characteristics can be identified which trade normally has....Sometimes the question whether an activity is to be found to be a trade or business becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact finding body to decide on the evidence whether a line has been passed." Taxpayer memo, p. [redacted].

The taxpayer lists what it considers to be eight (8) "badges of trade" as set forth in a published U.K. case. The taxpayer acknowledges that three of these badges are irrelevant since they concern only activities involving the sale of goods. The taxpayer plainly states that "[redacted] does not make sales of assets in the ordinary course of business- its only income is the receipt of management fees from [redacted]." Taxpayer memo, p. [redacted]. The taxpayer concludes that based on the remaining badges [redacted] did not carry on a trade of "providing management services". In reaching this conclusion, the taxpayer argues that [redacted] did not make a profit in any of the years at issue, did not hold itself out to the public to provide services and had only "one transaction" with its "immediate subsidiary."[4]

Overall, the taxpayer concludes that,

> "[redacted] was not a service provider, and that in no way, was [redacted] carrying on trade of providing [redacted]. There is no admitted trade in its tax returns (there is no Schedule D Case I income), and it is evident that its transactions are not carried on in accordance with a manner which you expect to see from a

[4]It is unclear exactly what the taxpayer is referring to regarding the one transaction with the subsidiary.

typical [redacted]." Taxpayer's memo. p. [redacted].

The taxpayer also mentions that [redacted]'s incorporation "solely to facilitate the de-merger of the [redacted] group of companies from [redacted]" supports its argument that [redacted] was not carrying on a [redacted]. Taxpayer memo, p. [redacted].

The taxpayer specifically states that the expenses incurred by [redacted] and carried forward by [redacted] on its U.K. returns are management expenses of an investment company under ICTA §75(3). Taxpayer memo, p. [redacted].

VII. Relevant U.K. law.[5]

A U.K. company carrying on a trade may carry forward the loss incurred in that trade to be used by that company to offset trading income from that trade in other accounting periods. ICTA §393(1) and (2).

U.K. law provides for "group relief" between related companies. Under the group relief provisions, trading losses and certain other amounts eligible for relief incurred in an accounting period may be surrendered by a company ("surrendering company") and allowed to another related company ("claimant company") to offset the profits of the claimant company. ICTA §§402(1) and 403(1). The plain language of ICTA §402(1) does not make any distinction between trading companies and investment companies. The surrendering company and the claimant company must be members of the same group. ICTA §402(2). Generally, a group exists if one company is a 75% subsidiary of another or both companies are 75% subsidiaries of a third company. ICTA §413(3)(a).

Another type of group relief allowed between related parties is when either the surrendering or claimant company is a member of a consortium and the other is-

> (a) a trading company which is owned by the consortium and which is not a 75% subsidiary of any company; or

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[5]Our office does not intend this discussion to be an exhaustive analysis of U.K. law. Rather, our office merely seeks to provide the examination team with a basic understanding of the U.K. law necessary to at a minimum address the specific issues raised by the taxpayer in its memorandum.

(b) a trading company which is a 90% subsidiary of a holding company which is owned by the consortium; and which is not a 75% subsidiary of a company other than the holding company; or

(c) a holding company which is owned by the consortium and which is not a 75% subsidiary of any company.

ICTA §343 concerns "company reconstructions," i.e. reorganizations. ICTA §343(1) concerns the situation where one company ("the predecessor") ceases to carry on a trade and another company ("the successor") begins to carry it on and the trade, or a 75% or more interest in the trade, belongs to the same persons as the trade or interest belonged to within a year prior to the transfer. ICTA §343(3) provides for carry forward of trading losses where ICTA §343(1) applies and one company succeeds to the operations of another company. Under ICTA §343(3), generally the successor is entitled to claim a loss which the predecessor would have been entitled to claim if it had continued the trade, i.e. could have carried forward the loss under ICTA §393(1).

ICTA §75 provides the authority for an investment company to deduct management expenses. ICTA §75(3) allows an investment company to carry forward unused management expenses to a succeeding accounting period. For purposes of ICTA §75, an investment company is an investment company as defined in ICTA §130. Tintern Close Residents Society Ltd. v. Winter (Inspector of Taxes), [1995] STC 67. ICTA 130 provides that an "'investment company' means any company whose business consists wholly or mainly in the making of investments and the principal part of whose income is derived therefrom..."

VIII. The taxpayer has not met its burden of proving that [redacted]'s losses meet the exception to the definition of a dual consolidated loss under Treas. Reg. §1.1503-2(c)(5)(ii)(A).

Based on our review of the taxpayer's [redacted] memorandum our office concludes that the taxpayer has not met its burden of proving that [redacted]'s losses meet the exception to the definition of a dual consolidated loss under Treas. Reg. §1.1503-2(c)(5)(ii)(A).

A. By limiting its argument to ICTA §343, the taxpayer has not addressed all conceivable means by which [redacted]'s losses may be carried over under U.K. law to offset the income of any another person in another taxable year.

As stated earlier, under the "carry over" test of the exception to the definition of a dual consolidated loss the taxpayer bears the burden of proving that the foreign law does not permit the loss to be used by any means to offset the income of any other person in another taxable year. Treas. Reg. §1.1502-2(c)(5)(ii)(A)(2). In its memo, the taxpayer states that the only means by which another person could use the loss of [redacted] in another taxable year is through ICTA §343. After concluding that ICTA §343 would not be applicable to the type of loss incurred by [redacted], the taxpayer summarily states that "there is no possible method for the losses of [redacted] to carry over to another UK corporation, or other entity or person." Taxpayer memo, p. [redacted]. In our opinion, the taxpayer's approach does not meet its burden of proving the carry over test.

As stated earlier, the burden of proving the carry over test is a lofty one and is rarely met. TD 8434 1992-2 C.B. 240, 241. The Service recently addressed this burden of proof in a field service advisory. In FSA 20022018 (February 13, 2002) 2002 TNT 102-73 ("FSA"), the Service in very strong and instructive language reinforced its position that the burden is indeed very difficult to meet. With respect to the burden borne by the taxpayer to prove that the "stand alone" and more particularly the "carry over" test under Treas. Reg. §1.1503-2(c)(5)(ii)(A) are met, the Service opined,

> "The burden is on the taxpayer to prove that these tests are met. It is a difficult burden to overcome. That difficulty arises because the taxpayer must prove a negative; that is, the taxpayer must show that it *cannot* use the losses, expenses, or deductions, *by any means* to offset the income of another person under the tax laws of a foreign country. Thus, the taxpayer must be able to address every conceivable means by which the losses might be used. For example, under the carry over test, if the taxpayer is able to share its losses, deductions, or expenses through a reorganization, liquidation, sale or other disposition, the taxpayer fails the test and the loss is a dual consolidated loss. Furthermore, if the taxpayer is able to share the losses in a partnership arrangement by using allocations of income and expenses that differ between federal income tax law and the foreign tax law, the

carry over test is not satisfied. These examples are not exhaustive; they merely illustrate some of the transactions in which losses might be shared.

The taxpayer cannot show that it meets these tests merely by stating conclusions. Rather, we believe that the taxpayer must present a well reasoned analysis that cites the specific foreign tax laws upon which it relies, together with other substantial authority that may exist, and applies those laws to the particular facts of the dual resident corporation." (emphasis included).

While an FSA can not be used or cited as precedent (section 6110(k)(3)), this FSA demonstrates that the Service interprets the phrase "by any means" under Treas. Reg. §1.1503-2(c)(ii)(5)(A)(2) very broadly. The Service requires that a taxpayer undertake the difficult task of affirmatively addressing in detail every conceivable means by which the loss may be used under the foreign law by another person in another tax year.[6] A taxpayer may not avoid addressing any conceivable means with a mere conclusory dismissal.

The FSA addressed two issues. The first issue was whether one specific foreign entity was a dual resident corporation. The second issue was whether the taxpayer had met its burden of proving that losses of other foreign entities, conceded by the taxpayer to be dual resident corporations, were excepted from the definition of a dual consolidated loss under Treas. Reg. §1.1503-2(c)(ii)(5)(A). The second issue is the only issue relevant to our case.

With regard to the second issue, the Service first addressed how corporations may "share" losses under the foreign law at issue.[7] The FSA refers to types of "claims" by which

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[6]The government has stated that the "carry over test" will rarely be met since most countries provide for some form of loss carry over. T.D. 8434, 1992-2 C.B. 240, 241 . At least one private publication recognized that "[p]ractically, it is very difficult to get an opinion from foreign counsel that a loss 'can 'never' be used by another person." Federal Income Taxation of Corporations Filing Consolidated Returns, 2d. Ed., Ch. 41.03, n. 69 (Matthew Bender 2002).

[7]The FSA actually addresses this issue under the laws of two countries, "FC1" and "FC2." [redacted]

corporations may share losses. While the published FSA is redacted and therefore the actual foreign country and laws are not referred to by name, [redacted]

In the FSA, the Service noted that it did not appear that the foreign entities owned any interest in any subsidiaries and only had U.S. shareholders. Therefore, the Service concluded that the taxpayer had met the "stand alone" test of Treas. Reg. §1.1503-2(c)(5)(ii)(A)(1) for these foreign entities.

The Service next addressed the "carry over" test. The taxpayer provided an opinion ("Opinion A") from its tax counsel regarding the "carry over" test. According to the FSA, Opinion A "notes that if a FC1 corporation has trading losses it is possible for those losses to be transferred to another company. See, for example, cite 7, which allows trading losses to be used in certain reorganizations."[8] In Opinion A it is argued that the activity at issue (net leasing of real estate) is not a trading activity. Essentially, this argument in Opinion A hinges on a facts and circumstances analysis of the activity. Opinion A concludes that the activity is not a trading activity, presumably no trading loss can exist, and therefore the reorganization provision can not be utilized.

The Service concluded in the FSA that the taxpayer had not met its "difficult" burden under the "carry over" test. The Service stated that its factual analysis of net leasing as a trading activity was not thorough enough to rule out the possibility that it could be a trading activity.

More importantly, the Service was not satisfied with the general approach taken by the taxpayer to meet its burden. In addition to its argument that the dual resident corporation did not engage in a trading activity and therefore did not have trading losses to transfer under FC1's reorganization provision,

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[redacted]

[8] [redacted]

the taxpayer, via Opinion A, analyzed seven scenarios to show other ways by which the losses would not be able to be shared under FC1 law. The Service was not satisfied with the taxpayer's discussion of the seven scenarios. The Service concluded that the approach fell short of what the taxpayer needed to do. The Service stated,

> "...Opinion A discusses only the direct use of the carried over losses. It does not discuss indirect use of losses, credits, or deductions, such as by basis carry over. Finally, we note there may be other transactions not covered by the seven mentioned in the opinion by which losses might be shared."

Overall, the Service concluded that the taxpayer had not met its burden of proving that the losses of the dual resident corporations fell under the exception to the definition of a dual consolidated loss.

The high hurdle of burden set by the Service, the specific facts of the FSA and the Service's discussion of those facts lead our office to conclude that the taxpayer in our case has not met its burden under the carry over test.

The taxpayer in our case does not address all "conceivable" means by which the losses of [redacted] may be used by any other person in any other taxable years under U.K. law. In the FSA, the taxpayer explained (although not necessarily adequately) why the losses could not be used under the reorganization provision as well as seven other specific scenarios. In our case, the taxpayer explains (also not necessarily adequately) only why the losses could not be used by another person under the reorganization provision of ICTA §343. As to any other scenarios, the taxpayer summarily concludes that "there is no possible method for the losses of [redacted] to carry over to another UK corporation, or other entity or person." Taxpayer memo, p. [redacted]. Therefore, the taxpayer in our case has done considerably less than the taxpayer in the FSA. The taxpayer in our case has failed to address any other ways by which the losses may be used. While the FSA makes it clear that its list of ways by which the losses may be used is not intended to be exhaustive, the taxpayer in our case has not even addressed any of the listed ways other than a reorganization.[9] If the burden was not met in the FSA, we do not see how it can possibly be met in our case.

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[9]The methods listed in the FSA which are not addressed by our taxpayer are liquidation, sale or other disposition, partnership arrangement and basis carry over.

We conclude that taxpayer's failure to substantively address all conceivable direct and indirect means by which another person may use the losses under U.K. law prevents it from meeting its burden of proving that [redacted]'s losses fall under Treas. Reg. §1.1503-2(c)(ii)(5)(A). Based on this alone, we recommend that the examination team take the position that the taxpayer has not met its burden.

For the purpose of completeness only, we will address other areas of the taxpayer's memo which we feel are troublesome.

B. The taxpayer fails to supports its conclusion that [redacted] is an investment company under ICTA §130 or that its expenses are management expenses under ICTA §75.

The taxpayer specifically states that the losses at issue result solely from [redacted]'s management expenses under ICTA §75. Taxpayer memo, p. [redacted]. ICTA §75 covers only management expenses of an investment company. ICTA §75(3) provides that an investment company may carry forward unused management expenses to offset income in a succeeding accounting period. The taxpayer also specifically states that [redacted] correctly carried forward the losses on its UK tax return under ICTA §75(3). Taxpayer memo, p.[redacted]. For purposes of ICTA §75, an "investment company" is an investment company as defined under ICTA §130. Tintern Close Residents Society Ltd. v. Winter (Inspector of Taxes), [1995] STC (SCD) 67; Johnson (Inspector of Taxes) v. The Prudential Assurance Co. Ltd., Chancery Division, 1996 STC 647, 70 Tax at 445. ICTA §130 provides that an "'investment company' means any company whose business consists wholly or mainly in the making of investments and the principal part of whose income is derived therefrom..." Therefore, when the taxpayer asserts that [redacted] correctly treated the management expenses as falling under ICTA §75, it must conclude as a threshold matter that [redacted] is an investment company under ICTA §130.

The taxpayer does not explain why [redacted] is an investment company under ICTA §130. The taxpayer states that a determination that [redacted] is an investment company would not be "conclusive" that it does not carry on a trade. Taxpayer memo, p. [redacted]. It is possible that the taxpayer avoided discussing this issue because it could not prove that [redacted] is an investment company.

Under the plain language of ICTA §130, for a company to be considered an investment company, its business must be "wholly or mainly in the making of investments and the principal part of its income derived therefrom." According to the taxpayer, [redacted]'s only activity was certain "[redacted]" functions performed

by the board of directors. Taxpayer memo, p. [redacted]. According to the taxpayer, [redacted]. Taxpayer memo, p. [redacted]. According to the taxpayer, [redacted]. Taxpayer memo, p. [redacted]. Under the plain language of ICTA §130 and the taxpayer's facts, we believe that whether [redacted] is an investment company is an open issue.

Decisions of the Special Commissioner in the U.K. support the conclusion that [redacted] was not necessarily an investment company, or at the very least, it can not simply be implied that it was. For example, in Tintern Close Residents Society Ltd. v. Winter (Inspector of Taxes), [1995] STC (SCD) 67 the issue was whether a company which was incorporated to hold and manage real properties for a fee paid by the owners of the properties was an investment company under ICTA §130 thus enabling it to deduct management expenses under ICTA §75.

In Tintern Close Residents Society Ltd., a developer built a housing development of 21 houses, a loft and 22 garages. The developer sold the houses to residents. The developer transferred certain land (common roadways and walkways, loft) to the taxpayer company ("taxpayer"). The taxpayer was incorporated to acquire, hold, manage and deal with the lands and buildings. The shareholders of the taxpayer were the residents of the houses. The residents paid a subscription to the taxpayer for its duties. Any subscriptions above expenses were placed in an account for future expenses. The account earned interest. The only income of the taxpayer was the subscriptions, the interest and the rent on the flat.

The Inland Revenue assessed a corporate tax on the interest for the [redacted] and [redacted] tax years. The taxpayer appealed to the Special Commissioner and claimed that it could deduct management expenses from its income before it was taxed.

The Special Commissioner stated that the issue was "whether the company was an investment company as defined by [ICTA] 130 and therefore entitled to relief for management expenses under the provisions of [ICTA] 75(1)?"

The taxpayer alleged that it was an investment company because its income was derived solely from the land that it owned. [10]

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[10]According to the decision, the taxpayer had previously appealed the same assessment for tax years [redacted] through [redacted]. For these years, the taxpayer argued that it could alternatively deduct the expenses as ICTA §75 management expenses of an

The Special Commissioner stated that under ICTA §130 an investment company's main business must consist "wholly or mainly in the making of investments." The Special Commissioner went on to list certain principles which should be applied to determine if a company is in the business of wholly or mainly in the making of investments: (1) whether the company was incorporated to acquire assets in order to turn them into a profit to be distributed to shareholders, (2) what activities are performed by the company, and (3) if the activities performed by the company are concerned with holding investments in order to make money from them, whether the purpose of holding the investments was to make money.

In Tintern Close Residents Society, the Special Commissioner first concluded that while one of the reasons the company was incorporated was to acquire land, the true purpose of the company was not to turn the land into profit for distribution to the shareholders. Rather, the Special Commissioner stated that the purpose of the company was,

> "directed to providing maintenance services for the owners of the houses and that is its main activity. The functions and activities of the company are the management and maintenance of the property at Tintern Close on behalf of the residents of the houses who pay subscriptions to cover the cost of any expenditure incurred."

The Special Commissioner further stated that the subscriptions collected in excess of immediate needs which were deposited by the taxpayer did not establish that the taxpayer's business consisted of "wholly or mainly in the making of investments." According to the Special Commissioner, "the deposits were subsidiary to the primary purpose of the company which is to manage and maintain the property." The Special Commissioner also concluded that the company did not make money by holding the land (other than possibly the rent on the flat). Overall, the Special Commissioner concluded that the taxpayer's business did not consists wholly or mainly in the making of investments. The taxpayer was not an investment company under ICTA §130 and

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investment company or as trading expenses of a trading company. The Special Commissioner determined that the taxpayer was not in the business of making investments. The Special Commissioner also stated that the taxpayer was neither an investment company nor a trading company. Thus far, our office has not been able to locate this prior decision and we are not sure if it is published.

therefore was not entitled to management expense relief under ICTA §75(1).

In our case, the taxpayer's own representations tend to support that [redacted] may not be an investment company. The taxpayer states that [redacted]. Taxpayer memo, p. [redacted]. Therefore, by the taxpayer's own account [redacted] was not incorporated to acquire assets to turn a profit for distribution to shareholders. In fact, the taxpayer states that [redacted]. Taxpayer memo, p. [redacted]. The taxpayer states that [redacted]. Taxpayer memo, p. [redacted]. According to the taxpayer, [redacted]. Taxpayer memo, p. [redacted]. Therefore, [redacted] is not in the business of making investments but rather (accepting the taxpayer's fact) it may at least be in the business of providing management services.

It is possible that [redacted] may not have been an investment company under ICTA §130.[11] If so, it could not have had management expenses under ICTA §75. Since the taxpayer glossed over ICTA §130 we can not guess what the taxpayer would consider the expenses if not under ICTA §75.

C. The taxpayer's reliance on a "fact and circumstances" analysis reinforces the conclusion that the taxpayer has not met its difficult burden of proof under Treas. Reg. §1.1503-2(c)(ii)(5)(A).

The taxpayer argues that the dispositive issue in the case is whether [redacted] is "carrying on a trade" under U.K. law. The taxpayer acknowledges that "carrying on trade" is not defined

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[11]Our research revealed one decision of the Special Commissioner in which the parties stipulated that a holding company of trading companies was an investment company under ICTA §130. Cadbury Schweppes plc v. Williams (Inspector of Taxes), (2002) STC (SCD) 115. In Cadbury Schweppes, the Special Commissioner stated that "[i]t is common ground that the taxpayer is an investment company within the meaning of §130 of the ICTA..." However, there is no further discussion of why the holding company is considered an investment company nor is there any authority cited. It is not known what type of income the holding company had or what functions it performed for the trading companies.

under U.K. statutory law. The taxpayer states that [redacted]. The taxpayer lists eight "badges of trade" several of which concern a company engaged in selling goods. The taxpayer alleges that [redacted].

The taxpayer does not discuss any U.K. case law with facts remotely on point with our case. Despite claiming that it must resort to U.K. case law to prove the fact sensitive issue that [redacted] is not carrying on a trade, the taxpayer actually does not brief the facts of any U.K. cases to prove its point. Rather, it analyzes badges of trade, several of which concern a company engaged in manufacturing a product. The taxpayer does not discuss any case law dealing with a company which provides services. The taxpayer also does not discuss any case law dealing with a holding company, or more specifically, a holding company owning companies which are unarguably trading companies.

As stated earlier, the taxpayer "must present a well reasoned analysis that cites the specific foreign tax laws upon which it relies, together with other substantial authority that may exist, and applies those laws to the particular facts of the dual resident corporation." We feel that the taxpayer's application of badges of trade would certainly not be considered "specific foreign tax laws" and "substantial authority" in support of its position since the taxpayer fails to discuss any U.K. case law factually on point. As a general comment, we feel that once the taxpayer delves into an admittedly purely factual issue such as whether a company is "carrying on a trade" under U.K. law it will have an extremely difficult time meeting its burden under Treas. Reg. §1.1503-2(c)(ii)(5)(A) absent factually indistinguishable authority.

Please be advised that this advisory memorandum is subject to post review by our National Office. If you have any questions, please contact attorney Robert T. Bennett of our office at (973) 645-3244.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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